ORS 71.2010(37)
Lease or Security
Agreement

Grassmueck v. Harvey (In re Helen Carol France),
Adversary No. 91-6157, Case No. 690-63479-H7

6/22/93 J., Hogan reversing PSH unpublished

Interpreting former O.R.S. 71.2010(37), the District Court (Judge Hogan) determined that a "lease" of a food dryer was a security agreement and not a true lease. By the "lease" terms, the debtor could keep the dryer after making all monthly payments but was under no obligation to make all such payments. Judge Hogan held that courts may not consider whether there is an "obligation" to be secured when applying the statute, effectively overruling prior holdings by Judge Radcliffe, in In re Unger, 95 B.R. 761 (Bankr. D. Or. 1989), and Judge Hess, in In re Colin, 136 B.R. 856 (Bankr. D. Or. 1991), that rent-to-own agreements are true leases.

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF OREGON

In re HELEN CAROL FRANCE, Debtor.	No. CV-92-6358-HO Bankruptcy Case No. 690-63479-H7 Adversary Proceeding No. 91-6157-H
MICHAEL A. GRASSMUECK, Inc., Trustee, Plaintiff-Appellee, vs. CHARLES HARVEY, RHONDA HARVEY, SKIP MAGEE and JANET E. MAGEE, NORTH BAY SAVINGS BANK, fka North Bay Savings and Loan Association, Defendants-Appellants.	OPINION

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HOGAN, Judge:

The trustee appeals from the Bankruptcy Court's determination that a lease agreement was a true lease rather than a security agreement. For the reasons which follow, I reverse.

BACKGROUND

Before debtor's bankruptcy was commenced, she entered into an "Equipment Lease Agreement" (the agreement) with the defendants Harvey. Under that agreement, debtor took possession of a freeze dryer and was obligated to make 60 monthly payments to the Harveys of $ 490.25. Once all payments were made, debtor was to take title to the dryer for no additional consideration. The agreement also provided that if debtor defaulted, she would "be obligated to return [the dryer] at the expense of [debtor]; all payments to be forfeited to [the Harveys]."

Debtor filed her voluntary bankruptcy proceeding before she had made all of the payments. Shortly after, the Harveys repossessed the dryer. The trustee subsequently brought claims against the Harveys for, inter alia, avoidance of a post-petition transfer, turnover of property, and avoidance of unperfected liens. 11 U.S.C. §§ 549, 542, and 544. The trustee moved the bankruptcy court for summary judgment on these claims, and the Harveys filed a cross motion for summary judgment.

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A threshold issue in the cross motions was whether the agreement was a true lease or a security agreement under former ORS 71.2010(37). The bankruptcy court determined the agreement was a true lease and granted the Harveys' summary judgment motion. The bankruptcy court denied the trustee's motion for reconsideration, but granted the trustee's motion for leave to appeal.

STANDARD OF REVIEW

In bankruptcy matters, the District Court acts as an appellate court. The bankruptcy court's findings of fact are generally reviewed under the clearly erroneous standard, and its conclusions of law de novo. In re Daniels-Head & Associates, 819 F.2d 914, 918 (9th Cir. 1987).

ISSUE PRESENTED

The issue presented is whether the agreement was a true lease or a security agreement under former ORS 71.2010(37(b).

APPLICABLE LAW

Whether an agreement constitutes a true lease or a security agreement is governed by the state law in effect at the time the agreement was made. In re Unger, 95 Bankr. 761, 764 (Bankr. D. Or. 1989); In re Colin, 136 Bankr. 856, 857 (Bankr. D. Or. 1991).

On December 30, 1988, when the agreement at issue in this case was made, ORS 71.2010(37) provided, in pertinent part:

> 'Security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation . . . . Whether a

> lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.

(emphasis added).

DISCUSSION

Former ORS 71.2010(37) was based on a Uniform Commercial Code section -- § 1-201(37) -- that was adopted by numerous states in addition to Oregon. In Peco, Inc. v. Hartbrauer Tool & Die Co., 262 Or. 573, 500 P.2d 708 (1972), the Oregon Supreme Court interpreted the section to provide that a lease which allows the lessee to obtain the leased property for no additional consideration or for nominal consideration is a security interest -- and not a true lease -- as a matter of law. Id. at 708-09. Only where the lease does not include such terms, the Peco court reasoned, is it necessary to determine by the facts of the case whether the lease was intended as security. Id.

Ten years later, the Ninth Circuit reached the same conclusion interpreting the parallel provision of California law in In re J.A. Thompson & Son, Inc., 665 F.2d 941 (9th Cir. 1982). The Ninth Circuit reasoned that

> [The statute] makes it clear that the question whether a lease was 'intended as security' is determined by reference to the intention of the parties at the time the transaction was

> consummated. In general, this intention is to be inferred from the facts of each case. In subsections (a) and (b), however, two plain rules of construction are set out. While a purchase option does not in itself make a lease one intended for security [as provided in subsection (a)], a purchase option exerciseable for no or nominal additional consideration 'does make' the lease one intended for security [under seubsection (b)]. We conclude from this that subsection (b) provides an exception to the general rule, whereby one fact in a given case takes on determinative significance.

665 F.2d at 946-47.

The Ninth Circuit expressly rejected an alternative interpretation that had been adopted by several other states' courts in the years following Peco. Id. at 946 & n.7. Under this view, a lease is not a conditional sale unless it positively obligates the lessee "to pay in rent an amount substantially equivalent to the designated purchase price of the property," regardless of whether it also allows the lessee an option to purchase for little or no consideration. Id., n.7. Thus, a lease terminable by the lessee "before making such an equivalent payment" is not a conditional sale, because the lessee is not sufficiently obligated. Id. The Ninth Circuit found this approach unpersuasive and refused to follow it, although observing that the leases at issue in Thompson were terminable by the lessee and thus within the rationale of the alternative approach. Id.

Defendants Harvey assert the alternative view in support of their contention that the agreement in this case is a true lease rather than a conditional sale/security agreement. They

argue there was not a sufficient obligation on the debtor's part for the agreement to consititute a security agreement because the agreement gave debtor the right to simply default and return the dryer. In support, defendants cite two decisions of the District of Oregon Bankruptcy Court in which the alternative interpretation of ORS 71.201(37) was applied: In Re Unger, 95 Bankr. 761, 765 (Bankr. D. Or. 1989) and In re Colin, 136 Bankr. 856, 858 (Bankr. D. Or 1992). The Bankruptcy Court also cited Unger in support of its conclusion that the agreement was a true lease.

Unger involved "rent-to-own" agreements concerning home entertainment equipment. The agreements were terminable at any time by the lessee. Because the lessee could simply return the equipment without further obligation, the court reasoned that there was no obligation to secure, and that the agreements were true leases rather than conditional sale/security agreements. 95 Bankr. at 765. The Unger court distinguished both Peco and Thompson on the basis that neither had involved an agreement that permitted the lessee to terminate the agreement without further liability. Id. As regards Thompson, however, this distinction does not apply, as the leases there were terminable by the lessee. The Ninth Circuit expressly noted as much in rejecting the alternative "no obligation" approach. See 645 F.2d at 946 n.7; see also id. at 943 (Thompson agreements were terminable "by [lessee] by way of written notice to [lessor] or by [lessor] upon the default of [lessee.]").

The Colin court did not mention Peco or Thompson, but did note that if "the literal language" of ORS 71.2010(37) were applied to the agreement before it, "the agreement must be treated as a contract of sale [rather than as a lease]." 136 Bankr. at 858. Because the lessee had enjoyed the right to terminate the agreement without making price-equivalent payments, however, the court declined to literally apply the statute. To do so, the court reasoned, would have led to an "absurd" result. Id.

Neither Unger or Colin yield persuasive bases for deviating from the literal meaning of ORS 71.2020(37). To conclude here, as I do, that the agreement in this case was a conditional sale/security agreement is no more absurd than to conclude it was a true lease despite the contrary dictates of ORS 71.2020(37)(b).

CONCLUSION

Under former ORS 71.2020(37), the "Equipment Lease Agreement" entered into by debtor and the defendants Harvey constituted a conditional sale/security agreement, rather than a true lease. The Bankruptcy Court's contrary ruling, by Order filed April 21, 1992, is reversed, and this action is remanded for further action in accord with this Opinion.

DATED this 21st day of ~~May~~ June, 1993.

Michael R. Hogan

MICHAEL R. HOGAN
United States District Judge

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF OREGON

In re HELEN CAROL FRANCE, Debtor.	No. CV-92-6358-HO Bankruptcy Case No. 690-63479-H7 Adversary Proceeding No. 91-6157-H
MICHAEL A. GRASSMUECK, Inc., Trustee, Plaintiff-Appellee, vs. CHARLES HARVEY, RHONDA HARVEY, SKIP MAGEE and JANET E. MAGEE, NORTH BAY SAVINGS BANK, fka North Bay Savings and Loan Association, Defendants-Appellants.	O R D E R

HOGAN, Judge:

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filed April 21, 1992, is reversed, and this case is remanded for further action in accord with the accompanying Opinion.

IT IS SO ORDERED.

DATED this 21st day of ~~May~~ June, 1993.

Michael R. Hogan

MICHAEL R. HOGAN
United States District Judge

Entered

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

In re
HELEN CAROL FRANCE

Debtor.

v.

Civil No. 92-6358-HO,
Bankruptcy 690-63479-H7

MICHAEL A. GRASSMUECK, INC.
Trustee,

Plaintiff-Appellee

v.

CHARLES HARVEY, RHONDA HARVEY, et al

Defendant/Appellants

JUDGMENT

The Bankruptcy Court's contrary ruling, by order filed April 21, 1992, is reversed, and case is remanded for further action.

Dated: June 23, 1993.

Donald M. Cinnamond, Clerk
by Lea Force
Lea Force, Deputy

JUDGMENT **DOCUMENT NO:** _____

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